VZCZCXRO4024
RR RUEHAG RUEHCN RUEHDF RUEHGH RUEHIK RUEHLZ
DE RUEHGZ #6330/01 1520728
ZNR UUUUU ZZH
R 010551Z JUN 06 ZDK
FM AMCONSUL GUANGZHOU
TO RUEHC/SECSTATE WASHDC 9645
INFO RUEHOO/CHINA POSTS COLLECTIVE
RUCNMEM/EU MEMBER STATES COLLECTIVE
RUEHOT/AMEMBASSY OTTAWA 0326
RUEHBR/AMEMBASSY BRASILIA 0017
RULSDMK/DEPT OF TRANSPORTATION WASHDC
RUWMDUA/FAA WESTERN PACIFIC RGN HQ LOS ANGELES CA
RUCPDOC/USDOC WASHDC
RUEATRS/DEPARTMENT OF TREASURY WASHINGTON DC
RUEAIIA/CIA WASHDC
RUEKJCS/DIA WASHDC
RHHMUNA/HQ USPACOM HONOLULU HI

UNCLAS SECTION 01 OF 04 GUANGZHOU 016330

SIPDIS

SENSITIVE
SIPDIS

STATE FOR EAP/CM AND EBA/TRA/AN ENGLE, DEMARS
STATE PASS USTR FOR STRATFORD/WINTER/ALTBACH
BEIJING FOR CRAIG REILLY
TOKYO FOR FAA
DOT FOR OFFICE OF INTL AVIATION OPPLER, BLOCH, GLATZ
COMMERCE FOR ITA/MAC- DAS LEVINE, MCQUEEN
COMMERCE FOR ITA/TD- ALFORD

E.O. 12958: N/A
TAGS: EAIR ECON KTIA CH
SUBJECT: SHENZHEN AIRLINES PLANS TO SOAR

GUANGZHOU 00016330 001.2 OF 004

(U) THIS DOCUMENT IS SENSITIVE BUT UNCLASSIFIED. PLEASE PROTECT ACCORDINGLY.

¶1. (SBU) Summary. During a recent meeting, Shenzhen Airlines Vice President Zhang Pei laid out the airline's ambitious expansion strategy. Operating mostly Boeing aircraft, Shenzhen Air runs an efficient operation that has made it China's most profitable airline after flag carrier Air China. However, its route network is relatively small and focused largely on South China. Nonetheless, in ten years' time, Shenzhen Air plans to be operating a fleet of more than 150 aircraft across an extensive route network that will include numerous international routes, all while retaining the reputation for good service that has earned it top spot in passenger satisfaction surveys for the past eight years. End summary.

Company Profile

¶2. (U) During a recent meeting with Consulate officials, Shenzhen Airlines Vice President Zhang Pei discussed the airline's expansion plans, and shared his views on the future of aviation in Shenzhen and the Pearl River Delta (PRD). Shenzhen Air was founded in 1992 and its maiden flight took off on September 17, 1993. Since then, the airline's fleet has grown from two to 35 aircraft, the vast majority of which (32) belong to the Boeing 737 family (300, 700, 800 and 900 series). The remaining three aircraft are Airbus planes: one A320 and two A319. Shenzhen Air plans to add 13 new aircraft (seven Boeings and six Airbuses) to the fleet by the end of 2006, bringing the total to 48. According to passenger satisfaction surveys, Shenzhen Air has been the preferred airline in China during the last eight years.

A Local Company

¶3. (U) Shenzhen Air prides itself in its origins as a "local company" (`difang gongsi'), organized and funded largely by the Shenzhen government and local enterprises. The airline then underwent ownership reform, and Guangdong Development Bank (GDB) acquired a controlling 65% interest. In 2005, GDB auctioned off its shares to two private companies, Huirun Investment and Yiyang (Bright Ocean) Group, for RMB 2.72 billion (USD 328 million). Air China (25%) and the Shenzhen government (10%) hold the remaining shares.

A Young Company As Well

¶4. (U) Shenzhen Air employs more than 5,000 employees, about 2,000 of them in its core business. The remaining 3,000 work in its upstream and downstream businesses, which include a catering service, travel agencies, and a hotel in downtown Shenzhen. The average age of a Shenzhen Air employee is 27, and the airline has no more than 20 employees over the age of 50.

Not Just Shenzhen's Hometown Airline

¶5. (SBU) Shenzhen Air currently operates more than 80 routes, the vast majority of them domestic. As one would guess, the airline's main hub is in Shenzhen. From the city's Bao'an International Airport, Shenzhen Air flies to over 45 domestic destinations. Internationally, the airline has flown from Shenzhen to Kuala Lumpur and Seoul, but those flights are currently suspended. It also plans to begin flights to Ho Chi Minh City in August. (Note: The suspensions were not mentioned during the meeting, and neither was the fact that the Ho Chi Minh flights were still

in the planning stage. We found out these facts after calling the airline's hotline to ask why the Ho Chi Minh and Seoul flights -- but not the ones to Kuala Lumpur -- were omitted from the airline's online flight schedule. End note.)

¶6. (U) The airline also has operational bases in Guangzhou, Nanning (Guangxi), Wuxi (Jiangsu), and Shenyang (Liaoning), and plans to open one in Zhengzhou (Henan) this summer. These are all modest affairs, but the airline plans to use some of the new aircraft it will receive later this year to bolster these regional bases.

Go West (And North And Abroad), Young Airline

¶7. (SBU) Meanwhile, the recent opening of a base in Shenyang highlights Shenzhen Air's intention of expanding its operations in China's northeast. The airline hopes to open up new bases in the west of the country within the next three years.

Shanghai, Here We Come

¶8. (SBU) Although South China will remain the airline's core area of operations, Shenzhen Air is poised to significantly "penetrate" the booming Yangtze River Delta (YRD), centered around Shanghai. The airline recognizes that Shanghai's own two airports, Pudong and Hongqiao, are tough, saturated nuts to crack, and plans instead to aim at nearby airports, a strategy that has proved successful for low-cost carriers (LCC) in Europe and the United States. To this end, the airline has acquired the airports in Nantong (Jiangsu) and Changzhou (Jiangsu), cities 60 and 100 miles away from Shanghai, respectively. Meanwhile, its existing base in Wuxi is 80 miles away, and the airline plans to buy that

airport as well.

In Three Years, The Chinese LCC

¶9. (SBU) Turning to the airline's long-term plans, Vice President Pei explained that, under the leadership of President Li Kun (a former vice president at rival China Southern Airlines), Shenzhen Air set what is known as the 3-6-9 Strategy for expansion, marked by three-, six- and nine-year plans. The three-year plan calls for an expanded fleet of 60-70 narrow-body planes, e.g., 737s, with a route network that would continue to focus on domestic destinations, plus those in nearby countries. In Pei's words, the airline does not aspire to become China's "number one" during this period, but instead wishes to establish itself as the "LCC with Chinese characteristics."

In Six, A Globally Known Brand

¶10. (SBU) Looking ahead to the six-year mark, Shenzhen Air's plans take a decided turn for the ambitious. By that time, it not only plans to be an intercontinental airline, flying to Europe and North America, but it plans to do so as a respected, well-known brand (`mingpai'), ostensibly moving away from the LCC tag.

In Nine, First Choice In Air Travel

¶11. (SBU) Finally, in nine years, Shenzhen Air hopes to have a "global presence" and be passengers' "first choice," operating a fleet of 150-160 planes. At that time, it plans to operate more than ten hubs in China, including one in Beijing, where it would focus its international operations.

Profiteers

¶12. (U) Shenzhen Air embarks on its path to glory from solid ground. In the first quarter of 2006, Shenzhen Air's business revenue was the second-highest among Chinese airlines, after Air China. This is not a small feat given Shenzhen Air's relatively low number of flights and its lack of profitable long-haul international routes. With profits before tax of RMB 120 million (USD 14.94 million) in the first quarter, the airline is set to surpass its target of RMB 200 million (USD 24.9 million) for the whole year in less than half that time.

The Secret Of Their Success

¶13. (U) Rising fuel prices are the bane of Chinese airlines' existence, but in spite of that situation, Shenzhen Air has managed to keep its costs low and, in turn, its profits high. Vice President Pei attributes the airline's success in this regard to two key factors: One, the airline pays much more attention to effective flight planning than its domestic rivals. While some companies establish flight routings and fuel loads only twice a year, at Shenzhen Air every flight is routed individually, taking into account its particular payload, as well as the current weather and the type of aircraft operated. This gives the airline the opportunity to save at least some fuel on each flight. Meanwhile, personnel -- pilots, flight planners and dispatchers -- are given bonuses for saving fuel. It is also standard company policy to tow aircraft while on land, rather than letting them taxi on their own power.

Safety Is Tops

¶14. (U) Despite the vital efforts to save fuel, Vice President Pei reiterated that there was no penalty imposed for a failure to save fuel or use more than was planned, in the interest of safety. The airline is proud of its strong security record, and its incident rate stands at a low 0.2 per million hours. In its 13 years of operations, the airline has not suffered a single crash, and not one life has been lost during the course of its operations.

Pilot Shortage

¶15. (SBU) Shenzhen Air's preferred source for incoming pilots is the military, but in recent years the number of available flyboys has decreased, while competition for them has increased. The airline also takes fresh graduates from flying school, often sending them on to more training, but at times this has not been enough to cover its demands, and it has resorted to hiring foreign pilots. At the height of this practice, it had in its payroll 60 pilots from 16 countries, but now the number is down to 19. Intriguingly, Shenzhen Air's leading source for foreign pilots is Brazil. (Note: This would make more sense if Shenzhen Air operated any Brazilian-made Embraer aircraft, but it does not. End note.)

Visa Woes

¶16. (SBU) Vice President Pei took advantage of the opportunity to comment on problem his company has allegedly faced because of current U.S. visa policies. Pei claimed that many of his pilots bound for training in the United States have had their applications held up because of the need for further processing, causing grave inconveniences

for the airline, as the pilots must sometimes wait months for the next course to start. Quick off the mark, the Canadian consul general in Hong Kong has made strong overtures to the airline, highlighting both the caliber of Canadian aviation academies and the relative ease of obtaining a Canadian visa. (Note: Our consular section notes that, since the beginning of 2005, it has issued visas to 18 Shenzhen Air pilots. With two SAO-related exceptions at the beginning of 2005, all were issued within two or three days of the interview. This appears to be yet another example of public perceptions that are not in line with actual practices. End note.)

Delta Force

¶17. (SBU) Turning to a discussion on the future of air travel in Shenzhen, Pei opined that Bao'an Airport had very limited potential as an international gateway for passengers. Hong Kong International Airport (HKIA), with its array of flights to every corner of the world, is easily accessible from Shenzhen and neighboring cities, and special arrangements in place obviate the need for passengers incoming from China and Macau to clear Hong Kong entry formalities before boarding a flight at HKIA. Meanwhile, Guangzhou's Baiyun Airport still has formidable potential for growth in terms of handling capacity. (Note: In a later meeting with EconOffs (septel), Shenzhen Metro officials mentioned that future plans call for switching most of HKIA's China-bound flights to Shenzhen, allowing HKIA to focus on international flights solidifying Shenzhen's role as Hong Kong's aerial gateway to China. End note.)

¶18. (SBU) While turning the international passengers over to Hong Kong and Guangzhou, Shenzhen seeks to carve a niche as an international air cargo hub for the PRD. Doing its part to help, Shenzhen Air is the majority shareholder (51%) in Jade Cargo International, a joint venture with Lufthansa and

other German concerns, which is the first cargo airline in China with any foreign ownership. Jade is set to being operations in July with two 747-400s, and it plans to bring the size of its fleet up to six by the end of 2007.

Comment: Staying Aloft

¶19. (SBU) The projected growth of the Chinese aviation market reaches such heights that Shenzhen Air may well be operating 160 planes across a worldwide network by 2016, at the same time its rivals that survive consolidation experience comparable growth. To accomplish this, however, the airline must continue of its path away from its roots as a strictly local airline. The airline's expansion in the booming YRD and up-and-coming Sichuan will be key. Meanwhile, even if the plans prove a tad too ambitious for what is still one of China's second-tier airlines, its roots in the still-growing PRD and its reputation for good service should ensure that it remains a profitable, albeit relatively small, carrier.

DONG